



# State of Arizona Accounting Manual

Topic 20 Current Assets  
Section 40 Inventories

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## INTRODUCTION

Since agencies maintain inventories of various types to support their operations, the statewide investment in inventories is considerable. Because of this, following an appropriate system of internal controls over inventories is crucial.

While the term "inventory" may at times be applied to various assortments of things, such as fixed assets and collections, this section of SAAM deals specifically with inventories of articles that are not considered as long-lived, viz., goods held for resale and supplies.

## POLICIES

1. There are two main types of inventory: items for resale and supplies.
  - 1.1. *Items for resale.* This type of inventory:
    - 1.1.1. Is comprised of goods that will be sold to the public or transferred to other agencies at their approximate cost.
    - 1.1.2. Is used by proprietary fund (i.e., enterprise funds and internal service funds) to keep track of their costs.
    - 1.1.3. Is also used to account for manufacturing functions (e.g., Arizona Correctional Industries and Arizona Industries for the Blind), which may further subdivide inventories into raw materials, working in process and finished goods.
    - 1.1.4. Except as it involves custodianship and internal controls, is managed and accounting for (including determination of cost) as determined to be the most appropriate by the agency.
  - 1.2. *Supplies inventories.* This type of inventory:
    - 1.2.1. Is the most common type of inventory encountered in State Government.
    - 1.2.2. Consists of items consumed by agency operations, and includes such things as office supplies, small tools, parts, oil and gas, etc.
    - 1.2.3. Is subject to the following policies and procedures:

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- 1.2.3.1. Materials may be released from storerooms only after storeroom personnel have verified the requester's authorization to obtain those materials. Authorization may be verified on the basis of system generated or hand-written requisitions, email, phone, or in-person requests. All requests should be documented and retained including the requestor's name, unit or department, and any required charge information.
- 1.2.3.2. All movements of inventory items (receipts, issues, transfers, returns, or adjustments) must be accounted for by the inventory accounting system whether this function is automated or performed manually and supported by journal entries.
- 1.2.3.3. The State uses the purchases method to account for supplies inventory. This method requires that disbursements for supply items to be treated as current period expenditures or expenses. The value of a supplies inventory is not tracked during the fiscal year and is determined at year-end as part of the physical inventory procedure. At year-end, the supplies inventory value will be calculated using the average cost method.
- 1.2.3.4. Items are to be issued, transferred, returned, or adjusted using an average cost method.
- 1.2.3.5. The average cost method means that as inventory purchases are received, the unit value of those purchases is combined with existing units to produce an average value of each inventory unit.
2. *Inventories of both items held for resale and supplies.*
  - 2.1. Inventories should, to the extent practical, be managed using the State's automated system for such purposes.
  - 2.2. An appropriate system of internal controls (i.e., a system applicable to the type and value of the items of inventory) must be established over all inventories.
  - 2.3. Inventories should be stored in a physically secure and controlled environment that reduces the risk of loss from fire, theft, temperature, humidity, and other elements.
  - 2.4. Storekeepers must count actual quantities received and compare these to vendor provided shipping documents, such as packing slips, bills of lading, or purchase order acknowledgements.
  - 2.5. Inventory items must be inspected upon receipt to ensure they are not damaged, defective, or otherwise incorrect.
  - 2.6. Storeroom managers shall determine that all items held in inventory are necessary to the operations of the organization.

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- 2.7. Inventory storerooms must be logically organized to facilitate the tracking and counting of items. As appropriate (when merited by cost or value), items should be numbered and have purchase and issuance units of measure associated to them as well.
- 2.8. It is recommended that frequent periodic and/or surprise counts be performed as well. Investigation and resolution of discrepancies should be performed.
- 2.9. Any discrepancies between the system records and the annual physical count must be investigated and resolved.
- 2.10. If at any point the system includes negative quantities, these must be investigated and resolved.
- 2.11. Items removed from inventory as obsolete, scrap, damaged, or returned to vendors must be recorded and accounted for.
- 2.12. Physical inventories help to provide accurate accounting records and to support fairly presented financial statements
  - 2.12.1. An annual physical inventory must be performed. A reconciliation to system records that includes the quantity and value of inventory items must be performed. This valuation will be submitted as part of the annual closing procedures in support of the CAFR.
  - 2.12.2. All physical inventory procedures should ensure complete and accurate counting of inventory.
  - 2.12.3. Methods and circumstances for performing the inventory, recounts of inventories, and authorization and recording of reconciling adjustments to inventories should be documented and reviewed by management.
  - 2.12.4. Annual physical inventories should be performed as close to fiscal year-end as possible. Unless otherwise authorized by the GAO, annual physical inventories of items held for resale and supplies should be conducted between May 1 and June 30 of each fiscal year. Additions, adjustments, issues and sales made between the date of the physical inventory and the amounts and values reported to the GAO as part of statewide annual closing procedures should be properly accounted for.
  - 2.12.5. Agencies should establish procedures so that inventory transactions are recorded in the proper fiscal year. Proper cutoff is an important step in determining the valuation of supplies inventories at year end.
  - 2.12.6. Agencies should sufficiently plan year-end cutoff of inventory issues, receipts, sales, returns and transfers. Additionally, the agencies should establish procedures for the clearance of all unprocessed receiving reports, sales

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inventory issue requisitions and other documents relating to movement or disposal of inventory.

3. Agencies should consider using the *Maximo* software system, which integrates with AFIS, to automate their inventory management.

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